

UNITED STATES DISTRICT COURT  
EASTERN DISTRICT OF WASHINGTON

UNITED STATES OF AMERICA,

Plaintiff,

v.

DON O. NICHOLS, et al.,

Defendants.

NO: 13-CV-0167-TOR

ORDER GRANTING IN PART THE  
UNITED STATES' MOTION FOR  
PARTIAL SUMMARY JUDGMENT

BEFORE THE COURT is the United States' Motion for Partial Summary Judgment (ECF No. 31). This matter was submitted without oral argument. The United States is represented by Dylan C. Cerling and Adam D. Strait. Defendants Don O. Nichols and Terry A. Nichols are represented by Charles H. Hammer. Defendant Last Day Trust has not appeared in this case and an order of default has been entered against it. ECF No. 28. The Court has reviewed the record and files herein, and is fully informed.

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## BACKGROUND

On May 29, 2013, the United States filed its first amended complaint seeking: (1) judgment against Defendants Don and Terry Nichols (collectively “the Nichols”) for unpaid federal income taxes and civil penalties for the years 1999, 2001–2009; (2) a determination that real property purchased by the Nichols in Reardon, Washington (the “subject property”), had been fraudulently transferred to Defendant Last Day Trust; (3) in the alternative, a determination that Last Day Trust holds title to the subject property as the nominee or alter ego for the Nichols; (4) a determination that the United States has valid tax liens against the Nichols’ property; and (5) an order foreclosing on the subject property to satisfy the tax liens. ECF No. 3.

The United States has alleged in its complaint that the Nichols filed frivolous federal income tax returns for the tax years 1999, 2001–2008. *Id.* at ¶13–17. The Secretary of Treasury has made assessments of federal income taxes, penalties, interest, and other statutory additions against the Nichols who have neglected or refused to make the requested payments. *Id.* at ¶ 15–17, 19. The Internal Revenue Service (“IRS”) has recorded statutory liens against all property and rights to property owned by the Nichols pursuant to 26 U.S.C. § 6321. *Id.* at ¶ 19–22.

1 The United States has also alleged that the Nichols purchased the subject  
2 property on August 17, 1984. *Id.* at ¶ 33. On December 10, 1998, a Real Estate  
3 Tax Affidavit was filed with the Spokane County Auditor changing the name on  
4 the property to “Don Nichols, Trustee of the Last Day Trust.” *Id.* at ¶ 34. This  
5 document noted that the change was “a mere change in identity.” *Id.* On  
6 December 31, 1998, the Nichols signed a statutory warranty deed purporting to  
7 convey the subject property to Don Nichols as trustee for the Last Day Trust in  
8 exchange for consideration in the amount of “zero dollars and no/110ths [sic].” *Id.*  
9 at ¶ 35. The United States further alleges that “[d]espite the purported transfers of  
10 the Subject Property, Defendants Don O. Nichols and Terry A. Nichols continue to  
11 occupy, possess, exercise dominion and control over, and have use and enjoyment  
12 of the subject property.” *Id.* at ¶ 37.

13 In response to interrogatories by the United States, the Nichols submitted  
14 draft 1040X returns and Schedule A forms setting forth the deductions to which the  
15 Nichols believed they were entitled in the years at issue. ECF No. 32 ¶ 39; 33-42  
16 at 8; 33-43 at 7. The United States now moves the Court for an order of partial  
17 summary judgment based upon undisputed facts established in those submissions  
18 and certified IRS records. ECF No. 31.

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## DISCUSSION

Summary judgment may be granted to a moving party who demonstrates “that there is no genuine dispute as to any material fact and that the movant is entitled to judgment as a matter of law.” Fed. R. Civ. P. 56(a). The moving party bears the initial burden of demonstrating the absence of any genuine issues of material fact. *Celotex Corp. v. Catrett*, 477 U.S. 317, 323 (1986). The burden then shifts to the non-moving party to identify specific genuine issues of material fact which must be decided by a fact-finder. *See Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 256 (1986). “The mere existence of a scintilla of evidence in support of the plaintiff’s position will be insufficient; there must be evidence on which the jury could reasonably find for the plaintiff.” *Id.* at 252.

For purposes of summary judgment, a fact is “material” if it might affect the outcome of the suit under the governing law. *Id.* at 248. A dispute concerning any such fact is “genuine” only where the evidence is such that a reasonable jury could find in favor of the non-moving party. *Id.* In ruling upon a summary judgment motion, a court must construe the facts, as well as all rational inferences therefrom, in the light most favorable to the non-moving party. *Scott v. Harris*, 550 U.S. 372, 378 (2007). Only evidence which would be admissible at trial may be considered. *Orr v. Bank of Am., NT & SA*, 285 F.3d 764, 773 (9th Cir. 2002).

1 The United States requests the following findings by the Court: (1) the  
2 Nichols are not entitled to certain deductions, (2) the Nichols are subject to certain  
3 penalties as well as interest, and (3) Last Day Trust acts wholly as a nominee or  
4 alter ego for the Nichols. ECF No. 31. The Nichols “do not deny that Last Day  
5 Trust was operating as a nominee entity,” nor do they object to any of the United  
6 States’ statements of undisputed fact. No. 38 at 2–4.

7 While the Nichols raise no factual objections, they do object to the United  
8 States motion on grounds that it is premature and maintain that a final tally of the  
9 Nichols’ tax liability will be established through negotiations. *Id.* at 2, 3. The  
10 United States has not requested the Court to determine a final amount of the  
11 Nichols’ tax liability in the current motion. This motion is not premature because  
12 the United States is entitled to narrow the field of issues for trial through a motion  
13 for partial summary judgment. *See, e.g., Sebastian Int’l, Inc. v. Russolillo*, 151 F.  
14 Supp. 2d 1215, 1217 (C.D. Cal. 2001) (“A court may grant summary adjudication  
15 on specific issues without granting summary judgment as to the entire cause of  
16 action so as to narrow the issues for trial.”); *Continental Airlines, Inc. v. Goodyear*  
17 *Tire & Rubber Co.*, 819 F.2d 1519, 1525 (9th Cir. 1987) (approving partial  
18 summary judgments that narrowed the issues, shortened any subsequent trial by  
19 months, and efficiently separated the legal from the factual questions). The Court

1 therefore considers whether, based upon the undisputed material facts, the United  
2 States is entitled to summary adjudication on each of the issues identified.

### 3 A. Deductions

4 Income tax deductions are “a matter of legislative grace and . . . the burden  
5 of clearly showing the right to the claimed deduction is on the taxpayer.”  
6 *Sparkman v. C.I.R.*, 509 F.3d 1149, 1159 (9th Cir. 2007) (quoting *New Colonial*  
7 *Ice Co. v. Helvering*, 292 U.S. 435, 440 (1934)); *see also Talley Indus. Inc. v.*  
8 *C.I.R.*, 116 F.3d 382, 387 (9th Cir. 1997) (“The taxpayer has the burden to  
9 demonstrate entitlement to a particular deduction.” (internal quotation marks  
10 omitted)). “Taxpayers are required to keep sufficient records to substantiate  
11 deductions.” *Sparkman*, 509 F.3d at 1159 (citing 26 U.S.C. § 6001; 26 C.F.R.  
12 § 1.6001-1(a)). “If evidence to establish a deduction is lacking, the taxpayer, not  
13 the government, suffers the consequence” and the deduction is not allowed. *Talley*  
14 *Indus. Inc.*, 116 F.3d at 387–88.

#### 15 1. Charitable Deductions

16 In their draft 1040X and Schedule A forms submitted to the United States,  
17 the Nichols claim certain charitable deductions. The United States contends that  
18 “the Nichols have not provided sufficient evidence to substantiate the purported  
19 charitable deductions” and requests the Court to “find the Nichols are not entitled  
20 to charitable deductions . . . in an amount greater than the receipts they have

1 provided” for the years 1999, 2001–2004, and 2007. ECF No. 31 at 9–10. The  
2 Nichols have not denied the United States’ factual allegations regarding the  
3 numbers represented on these draft forms nor that the Nichols lack appropriate  
4 receipts for some of the claimed contributions. *See* ECF No. 38.

5 In general, a taxpayer is allowed to deduct any contributions or gifts made  
6 to qualifying organizations for their use. See 26 U.S.C. § 170(a). 26 C.F.R.  
7 § 1.170A–13(a)(1) requires that charitable contribution deductions, whether made  
8 by cash or otherwise, be substantiated by at least one of the following:

9 (i) A canceled check.

10 (ii) A receipt from the donee charitable organization showing the name of  
11 the donee, the date of the contribution, and the amount of the contribution. A letter  
12 or other communication from the donee charitable organization acknowledging  
13 receipt of a contribution and showing the date and amount of the contribution  
14 constitutes a receipt . . . .

15 (iii) In the absence of a canceled check or receipt from the donee charitable  
16 organization, other reliable written records showing the name of the donee, the  
17 date of contribution, and the amount of the contribution.

18 If the donation is a small amount, any written or other evidence from the  
19 donee charitable organization acknowledging receipt is generally sufficient (e.g.,  
20 emblem, button, or other token). The reliability of the records is determined on the

1 basis of all relevant facts and circumstances. See 26 C.F.R. § 1.170A–13(a)(2)(C).  
2 To claim a charitable contribution deduction of \$250 or more, the taxpayer must  
3 substantiate the contribution with a contemporaneous written acknowledgment  
4 from the donee organization. 26 U.S.C. § 170(f)(8); 26 C.F.R. § 1.170A–13(f)(8).  
5 However, “[s]eparate contributions of less than \$250 are not subject to the  
6 requirements of section 170(f)(8), regardless of whether the sum of the  
7 contributions made by a taxpayer to a donee organization during a taxable year  
8 equals \$250 or more.” 26 C.F.R. § 1.170A–13(f)(8).

9 After reviewing the Nichols’ draft forms and substantiating evidence, the  
10 Court makes the following findings of undisputed fact:

- 11 (1) The Nichols’ 1999 draft 1040X return claims deductions for  
12 \$710.00 in charitable gifts of cash or check and \$245.00 in other  
13 charitable gifts. ECF No. 33-23 at 9. The Nichols have not  
provided any evidence substantiating these amounts.
- 14 (2) The 2001 draft 1040X claims deductions for \$2,515.00 in gifts of  
15 cash or check and \$240.00 in other gifts. ECF No. 33-25 at 11.  
The Nichols have substantiated \$2,515.00 in gifts of cash or check  
16 to the Lincoln City SDA Church, *id.* at 8, but have not  
substantiated the \$240.00 in other charitable gifts.
- 17 (3) The 2002 draft 1040X claims deductions for \$2,463.00 in gifts of  
18 cash or check and \$235.00 in other gifts. ECF No. 33-27 at 14.  
The Nichols have substantiated \$1,343.00 in gifts of cash or check  
19 to the Lincoln City SDA Church. *Id.* at 11. The Nichols have not  
substantiated the remaining \$1,120.00 in gifts of cash or check nor  
the \$235.00 in other charitable gifts.
- 20 (4) The 2003 draft 1040X claims deductions for \$9,159.00 in gifts of  
cash or check and \$245.00 in other gifts. ECF No. 33-29 at 19.



1 The Nichols have substantiated \$8,109.00 in gifts of cash or check  
2 to the Spokane Countryside SDA Church. *Id.* at 7. The Nichols  
3 have not substantiated the remaining \$1,050.00 in gifts of cash or  
4 check nor the \$245.00 in other gifts.

5 (5) The 2004 draft 1040X claims deductions for \$5,612.50 in gifts of  
6 cash or check and \$248.00 in other gifts. ECF No. 33-31 at 22.  
7 The Nichols have substantiated gifts of cash or check in the  
8 amounts of \$123.00 to the Spokane Central SDA Church and  
9 \$5,489.50 to the Spokane Countryside SDA Church. *Id.* at 7–8.  
10 The Nichols have not substantiated the \$248.00 in other gifts.

11 (6) The 2007 draft 1040X claims deductions for \$12,005.00 in gifts of  
12 cash or check and \$245.00 in other gifts. ECF No. 33-37 at 20.  
13 The Nichols have substantiated gifts of cash or checks in the  
14 amount of \$695.00 to the Gospel Heritage Foundation, \$3,539.00  
15 to the Spokane Countryside SDA Church, and \$420.00 to the  
16 Linwood Seventh-day Adventist Church. *Id.* at 11–15. The  
17 Nichols have not substantiated the remaining \$7,351.00 in gifts of  
18 cash or check nor the \$245 in other gifts.

19 Based on the foregoing, the Court concludes, absent additional evidence  
20 substantiating the claimed deductions, that: (1) the Nichols may not claim any  
deduction for charitable gifts in 1999, (2) the Nichols may claim only \$2,515.00 in  
charitable gifts in 2001, (3) the Nichols may claim only \$1,343.00 in charitable  
gifts in 2002, (4) the Nichols may claim only \$8,109.00 for charitable gifts in  
2003, (5) the Nichols may claim only \$5,612.50 for charitable gifts in 2004, and  
(6) the Nichols may claim only \$4,654.00 for charitable gifts in 2007. The United  
States is entitled to adjudication on these points as a matter of law.

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## 2. Real Estate Tax Deductions

The Nichols stated during their depositions that they might be entitled to certain real estate tax deductions. ECF Nos. 31 at 10; 33-2 at 16 (discussing how long it would take to verify a real estate deduction claim). None of the submitted draft 1040X returns or Schedule A forms make claims for deduction of state real estate taxes. *See* ECF Nos. 33-23 at 9; 33-27 at 14; 33-29 at 19; 33-31 at 22; 33-33 (does not include a Schedule A form listing itemized deductions); 33-35 (does not include a Schedule A form); 33-37 at 20. The Nichols have not submitted evidence that would substantiate any real estate deductions, nor do they dispute the United States' assertion that "the Nichols do not have evidence of such deductions." ECF No. 38. As such, the Nichols have not carried their burden to identify specific genuine issues of material fact on this matter. *See Anderson*, 477 U.S. at 256. The United States is entitled to adjudication that the Nichols may not claim state real estate tax deductions for the years at issue.

## 3. Commuting Expense Deductions

For the years 2003–2007, the Nichols' submitted Schedule C and Schedule C-EZ forms claiming business expense deductions for commuting costs, accompanied by handwritten notations detailing commuting mileages. ECF No. 33-29 at 4, 21 (\$6,523.20 deduction claimed in 2003); 33-31 at 9, 19 (\$8,411.25 deduction claimed in 2004); 33-33 at 14, 16 (\$3,264.30 deduction claimed in

1 2005); 33-35 at 15 (\$2,302.74 deduction claimed in 2006); 33-37 at 4–5, 18  
2 (\$4,121.88 deduction claimed in 2007). “A taxpayer’s costs of commuting or  
3 driving to work is not a deductible business expense . . . , but rather is a non-  
4 deductible personal expense[.]” *Sanders v. C.I.R.*, 439 F.2d 296, 297 (9th Cir.  
5 1971) (citations omitted). The United States is entitled to adjudication that the  
6 Nichols may not claim commuting expenses as a business deduction.

#### 7 B. Penalties and Interest

8 The United States asserts that the Nichols are liable for certain penalties,  
9 additions, and interest on their tax liabilities. ECF No. 31 at 13–18. Specifically,  
10 the United States asserts the Nichols are liable for (1) an accuracy-related penalty  
11 for understating the amount of taxes owing, (2) an addition for failing to make  
12 estimated payments, (3) an addition for failing to pay taxes assessed, (4) a penalty  
13 for frivolous returns, and (5) interest on the amounts due. *Id.* at 13–14.<sup>1</sup> The  
14 Nichols have not responded to these assertions. *See* ECF No. 38. Nevertheless,  
15 the burden rests upon the United States to produce evidence with respect to the

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16  
17 <sup>1</sup> The United States requests the Court to make findings that the Nichols have such  
18 additional liabilities, but clarifies that a determination of the actual amounts due  
19 may only be calculated following a final determination of the Nichols’ tax  
20 liabilities. *Id.* at 14.

1 Nichols' liability for any penalty, addition to tax, or other additional amount  
2 imposed by the tax code. 26 U.S.C. § 7491(c).

3 1. Accuracy-Related Penalties

4 The United States contends that the Nichols are liable for accuracy-related  
5 penalties for 1999 and 2004. ECF No. 31 at 14. The Nichols have not responded  
6 to this contention. *See* ECF No. 38.

7 A penalty is assessed upon "[a]ny substantial understatement of income tax."  
8 26 U.S.C. § 6662(a), (b)(2). An "understatement" is "the amount of tax required to  
9 be shown on the return," minus the actual amount of tax shown on the return.  
10 § 6662(d)(2)(A). An understatement is "substantial" if "the amount of the  
11 understatement for the taxable year exceeds the greater of . . . 10 percent of the tax  
12 required to be shown on the return . . . or \$5,000." § 6662(d)(1)(A).

13 In 1999, the Nichols filed a 1040 return stating that they had zero income,  
14 accompanied by a letter stating that they "did not earn 'wages' or 'gross income'  
15 as such terms are defined in the United States tax law." ECF No. 33-22 at 2–3, 5.  
16 As such, the Nichols 1040 return indicated they owed no income tax. *Id.* at 3. The  
17 draft 1040X amended return submitted by the Nichols shows an adjusted gross  
18 income for 1999 in the amount of \$47,530.62 with an estimated tax liability of  
19 \$2,510.47. ECF No. 33-23 at 7. The IRS has calculated the amount of tax due as  
20 \$5,501.00. ECF No. 33-3 at 3. Under the IRS's calculation, the Nichols' 1999

1 return understated their tax by more than \$5,000 and the Nichols would be liable  
2 for the penalty. Under the Nichols' own calculations in the draft 1040X, the return  
3 filed in 1999 understated their tax liability by \$2,510.47 which is more than 10%  
4 of the tax required to be shown—that is, the \$0.00 of tax liability shown on the  
5 filed return is a 100% understatement of the \$2,510.47 tax liability the Nichols  
6 now contend was owed. Under either calculation, the Nichols are liable for a  
7 § 6662 accuracy-related penalty for understating their tax liability in 1999.

8 In 2004, the Nichols again filed a 1040 return stating they had zero income,  
9 accompanied by a similar letter asserting they did not earn wages as defined by the  
10 U.S. Tax Code. ECF No. 33-30. The Nichols again asserted they owed no income  
11 tax. *Id.* at 3. The Nichols' draft 1040X amended return indicates that they had an  
12 adjusted gross income of \$50,438.87 in 2004 and owed an estimated \$10,792.40 in  
13 tax. ECF No. 33-31 at 17. The IRS has calculated the Nichols' tax liability as  
14 \$11,622.00. ECF No. 33-7 at 3. Under either calculation, the amount of tax  
15 indicated in the 2004 return was understated by more than \$5,000 or 10% of the  
16 tax liability required to be shown. The Nichols are subject to an accuracy-related  
17 penalty under § 6662 for understating their tax liability in 2004.

18 Because the Nichols would be liable for an accuracy-related penalty in 1999  
19 and 2004 based upon the amount of tax liability established by either the Nichols  
20 or the IRS, the exact amount due is not material for purposes of determining

1 whether the penalty applies. The United States is entitled to adjudication that the  
2 Nichols are liable for § 6662 accuracy-related penalties for substantial  
3 understatement of income tax in 1999 and 2004. The amount of those penalties  
4 (20% of the portion of underpayment) will be calculated upon a final determination  
5 of the Nichols' actual tax liabilities in those years.

## 6 2. Section 6654 Addition to Tax

7 The United States contends that the Nichols are liable for penalties for  
8 failing to make estimated tax payments in the years 2001–2003, 2005–2007. ECF  
9 No. 31 at 15–16. The Nichols have not responded to this contention. ECF No. 38.

10 The tax code imposes an addition to tax for underpayment of taxes. 26  
11 U.S.C. § 6654(a); *see also Harris v. C.I.R.*, 104 T.C.M. (CCH) 554 (2012). The  
12 addition is calculated with respect to four quarterly installment payments on the  
13 taxpayer's estimated tax liability. § 6654(a), (c). Each installment is equal to one-  
14 quarter of the taxpayer's "required annual payment." § 6654(d)(1)(A). The  
15 required annual payment is equal to the lesser of "(i) 90 percent of the income tax  
16 shown on the return for the taxable year (or, if no return is filed 90 percent of the  
17 tax for such year), or (ii) 100 percent of the tax shown on the return for the  
18 preceding taxable year." § 6654(d). This addition to tax "is mandatory unless the  
19 taxpayer proves an exception applies." *Harris*, 104 T.C.M. (CCH) 554 at \*6; *see*  
20 *also* 26 U.S.C. § 6654(e) (exceptions). Federal income tax withholdings from

1 wages are generally deemed payments on the estimated tax liability. *See* 26 U.S.C.  
2 § 6654(g).

3       The burden rests on the United States to prove the Nichols are liable for an  
4 addition. 26 U.S.C. § 7491(c). The United States has submitted certified Form  
5 4340 Certificates of Assessments, Payments, and Other Specified Matters (“Form  
6 4340”), covering the Nichols’ individual income tax accounts for each of the  
7 relevant years. These forms are admissible as public records. *Hansen v. United*  
8 *States*, 7 F.3d 137, 138 (9th Cir. 1993) (per curiam). They are also entitled to a  
9 presumption of correctness, absent evidence to the contrary, and are sufficient to  
10 establish the United States’ prima facie case that an addition applies. *See Hughes*  
11 *v. United States*, 953 F.2d 531, 535 (9th Cir. 1992); *United States v. Stonehill*, 702  
12 F.2d 1288, 1293 (9th Cir. 1983) (“The government can usually carry its initial  
13 burden, however, merely by introducing its assessment of tax due. Normally, a  
14 presumption of correctness attaches to the assessment, and its introduction  
15 establishes a prima facie case.”). Following the government’s prima facie  
16 showing, the burden shifts to the taxpayer to present evidence rebutting the  
17 correctness of the Form 4340s and establishing that genuine issues of material fact  
18 exist which warrant denial of a motion for summary judgment. *See Hansen*, 7 F.3d  
19 at 138; *Stonehill*, 702 F.2d at 1294. The Nichols have not disputed the accuracy of  
20 the Form 4340s nor have they presented contradictory evidence.

1 Based upon a review of the certified Form 4340s and the Nichols' filed  
2 returns, the Court makes the following findings of undisputed fact:

- 3 (1) In 2001, the Nichols filed a 1040 return estimating that they had no  
4 tax liability. ECF No. 33-24. That year, the IRS calculated Terry  
5 Nichols' taxable income as \$28,590.00 and assessed an income tax  
6 liability of \$4,177.00. ECF Nos. 3 at ¶ 16; 33-4. The Form 4340  
7 indicates no payments or withholding credits for the year. ECF No.  
8 33-4.
- 9 (2) In 2002, the Nichols filed a 1040 form estimating that they had no  
10 taxable income. ECF No. 33-26. The IRS calculated Terry Nichols'  
11 taxable income as \$26,537.00 and assessed an income tax liability of  
12 \$4,060.00. ECF Nos. 3 at ¶ 16; 33-5. The Form 4340 reflects a  
13 withholding credit of \$15.00, but no additional withholdings or  
14 payments. ECF No. 33-5.
- 15 (3) In 2003, the Nichols filed a 1040 form estimating that they had no tax  
16 liability. ECF No. 33-28. The IRS calculated Don Nichols' taxable  
17 income as \$49,669.00 and assessed an income tax liability of  
18 \$13,839.00. ECF Nos. 3 at ¶ 15; 33-6. The assessment records  
19 indicate no payments or withholding credit for the year. ECF No. 33-  
20 6.
- (4) In 2004, the Nichols filed a 1040 form estimating that they had no tax  
liability. ECF No. 33-30. The IRS calculated the Nichols joint  
taxable income as \$37,151.00 and assessed a tax liability of  
\$11,622.00. ECF Nos. 3 at ¶ 17; 33-7. The assessment records reflect  
a withholding credit of \$20.37 but no additional withholdings or  
payments. ECF No. 33-7.
- (5) In 2005, the Nichols filed a 1040 form estimating that they had no tax  
liability. ECF No. 33-32. That year, the IRS calculated Terry  
Nichols' taxable income as \$25,639.00 and assessed upon her a tax  
liability of \$3,479.00. ECF Nos. 3 at ¶ 16; 33-8. The IRS also  
calculated Don Nichols' taxable income as \$50,742.00 and assessed a  
tax liability upon him of \$15,011.00. ECF Nos. 3 at ¶ 15; 33-10. The  
assessment records show no withholding credits or payments for the  
year for either Terry or Don Nichols. ECF Nos. 33-8; 33-10.



1  
2 (6) In 2006, the Nichols filed a 1040 form estimating they had no tax  
3 liability. ECF No. 33-34. The IRS calculated Terry Nichols' taxable  
4 income as \$24,738.00 and assessed a tax liability of \$5,768.00. ECF  
5 No. 3 at ¶ 16; 33-12. The IRS calculated Don Nichols' taxable  
6 income as \$43,108.00 and assessed a tax liability of \$7,339.00. ECF  
Nos. 3 at ¶ 15; 33-14. The assessment records show no withholding  
credits or payments for Terry Nichols. ECF No. 33-12. The records  
show a federal income tax withholding credit in the amount of  
\$2,972.00 for Don Nichols, but no additional withholding credits or  
payments. ECF No. 33-14.

7 (7) In 2007, the Nichols filed a 1040 form estimating that they had no tax  
8 liability. ECF No. 33-36. The IRS calculated Terry Nichols' taxable  
9 income as \$20,309.00 and assessed a tax liability of \$7,076.00. ECF  
10 Nos. 3 at ¶ 16; 33-16. The IRS calculated Don Nichols' taxable  
11 income as \$79,302.00 and assessed a tax liability of \$16,707.00. ECF  
12 Nos. 3 at ¶ 15; 33-18. The assessment records show no withholding  
credits or payments for Terry Nichols. ECF No. 33-16. The records  
show a federal income tax withholding credit in the amount of  
\$7,188.00 for Don Nichols, but no additional withholding credits or  
payments. ECF No. 33-18.

13 Based upon the foregoing, the Court concludes that in each of the relevant  
14 years the Nichols filed returns showing that they had no estimated tax liabilities.  
15 The Nichols did not make any payments on their estimated tax liabilities in these  
16 years other than some negligible federal income tax withholdings on wages. The  
17 United States argues that the Nichols are liable for an addition on tax because they  
18 underpaid the amount of taxes the IRS later assessed. However, the amount that  
19 the IRS assessed is irrelevant for the application of an addition under § 6654. The  
20 statute requires a taxpayer to pay 90% of the estimated tax *shown* on the filed

1 return for that year or 100% of the estimated tax *shown* on the filed return for the  
2 preceding year. 26 U.S.C. § 6654(d)(1)(B).<sup>2</sup>

3 The Nichols are not liable for a § 6654 tax addition because they paid the  
4 required portion of the estimated tax liability shown on their returns. As the  
5 Nichols filed “zero returns” their required annual payment on estimated taxes for  
6 each of the relevant years is \$0.00, based upon the lesser of either 90% of the \$0.00  
7 liability shown on that year’s return or 100% of the \$0.00 liability shown on the  
8 previous year’s return. *See Linmar Prop. Mgmt. Trust v. C.I.R.*, 96 T.C.M. (CCH)  
9 176 at \*12 (2008). For example, in 2002, the Nichols’ required annual payment  
10 under § 6654(d)(1)(B) was the lesser of 90% of the \$0.00 tax liability shown on  
11 their 2002 return or 100% of the \$0.00 tax liability shown on their 2001 return.  
12 ECF Nos. 33-24; 33-26. The Nichols cannot underpay on the estimated null tax  
13 liabilities shown on each return filed. They are therefore not subject to an addition  
14  
15

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16 <sup>2</sup> Only where a taxpayer has failed to file a return does the addition apply to the  
17 failure to pay 90% of the assessed tax for a given year. *See* 26 U.S.C.  
18 § 6654(d)(1)(B) (. . .or, if no return is filed, 90 percent of the tax for such  
19 year . . .”). The Nichols did not fail to file returns in the relevant years. Thus,  
20 this provision does not apply.

1 under § 6654. The United States is not entitled to summary adjudication on this  
2 issue.

### 3 3. Section 6651 Additions to Tax

4 The United States contends that the Nichols are liable for additions to their  
5 tax for failing to “promptly pay their tax liabilities for any of the following tax  
6 years: 1999, 2001–2007.” ECF No. 31 at 16. The Nichols have not responded to  
7 this contention. *See* ECF No. 38.

8 The tax code imposes an addition to tax for failure “to pay the amount  
9 shown as tax on any return” or “to pay any amount in respect to any tax required to  
10 be shown on a return . . . which is not so shown (including an assessment made . . .  
11 within 21 calendar days from the date of notice and demand therefor) . . . .” 26  
12 U.S.C. § 6651(a)(2), (3).<sup>3</sup> The initial burden rests on the United States to produce  
13 evidence indicating that the taxpayer failed to make the required payments. 26  
14 U.S.C. § 7491(c); *Wheeler v. C.I.R.*, 127 T.C. 200, 207–08 (2006). The burden  
15 then shifts to the taxpayer to produce evidence that the failure was due to

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16  
17 <sup>3</sup> The addition to tax for such a failure to pay is “0.5 percent of the amount of such  
18 tax if the failure is for not more than 1 month, with an additional 0.5 percent for  
19 each additional month or fraction thereof during which such failure continues, not  
20 exceeding 25 percent in the aggregate.” § 6651(a)(2), (3).

1 reasonable cause and not due to willful neglect. 26 U.S.C. § 6651(a)(2), (3);  
2 *Wheeler*, 127 T.C. at 208.

3 In addition to the findings of undisputed fact described in the preceding  
4 section, the Court finds undisputed that in 1999 the Nichols filed a 1040 return  
5 estimating that they had no tax liability. ECF No. 33-22. The IRS calculated the  
6 Nichols' taxable income as \$36,667.00 and assessed an income tax liability of  
7 \$5,501.00. ECF Nos. 3 at ¶ 17; 33-3. The assessment reflects a withholding credit  
8 of \$515.53, but no additional withholdings or payments. ECF No. 33-3.

9 The Court further finds undisputed that the IRS provided the Nichols with  
10 notice and demand of the assessed tax liability for each of the relevant years.  
11 “[W]hen a deficiency exists, the Commissioner must issue a notice of deficiency  
12 and wait 90 days before assessing the tax.” *Jordan v. C.I.R.*, 102 T.C.M. (CCH)  
13 386 at \*2 (2011); *see also* 26 U.S.C. §§ 6212(a), 6213(a). Absent evidence to the  
14 contrary, the United States may rely upon Form 4340 records to verify that notice  
15 and demand were provided. *See Jordan*, 102 T.C.M. (CCH) 386 at \*3 (“If the  
16 taxpayer does not offer any evidence to show an irregularity, the IRS may rely on  
17 computerized records, including the Form 4340, to verify that the notice of  
18 deficiency was sent and the tax properly assessed.”). An entry on each of the  
19 Nichols' yearly assessment record reflects that the additional tax was assessed only  
20 after default on the statutory 90 day demand letter. ECF Nos. 33-3 at 3 (1999); 33-

1 4 at 3 (2001); 33-5 at 3 (2002); 33-6 at 3 (2003); 33-7 at 6 (2004);<sup>4</sup> 33-8 at 3 (2005  
2 for Terry Nichols); 33-10 at 3 (2005 for Don Nichols); 33-12 (2006 for Terry  
3 Nichols); 33-14 at 4 (2006 for Don Nichols); 33-16 at 3 (2007 for Terry Nichols);  
4 33-18 at 3 (2007 for Don Nichols). These entries are sufficient to establish that the  
5 Nichols were provided with notice of their deficiencies and demand for payment.  
6 *See Jordan*, 102 T.C.M. (CCH) 386 at \*3. Moreover, the Nichols do not dispute  
7 that they were provided with notice and demand to pay the liabilities assessed by  
8 the IRS. *See* ECF No. 38.

9 Finally, the Court finds, based upon the review of the Form 4340s, that the  
10 Nichols did not make any payments on the tax liabilities assessed by the IRS  
11 following the notice and demand thereof for any of the relevant years. *See* ECF  
12 Nos. 33-3; 33-4; 33-5; 33-6; 33-7; 33-8; 33-10; 33-12; 33-14; 33-16; 33-18. The  
13 Nichols have not disputed or presented evidencing contradicting this failure to  
14 make payments. As such, the Court concludes that the United States is entitled to  
15 adjudication that the Nichols are liable for additions to taxes in the years 1999,  
16  
17

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18 <sup>4</sup> The 2004 Form 4340 does not contain the same entry as the other records, but it  
19 does indicate that the “Statutory Notice of Balance Due” was provided. ECF No.  
20 33-7 at 6.

1 2001–2007 for failing to pay the amount required by the IRS assessments after  
2 notice and demand thereof, pursuant to 26 U.S.C. § 6651(a)(3).<sup>5</sup>

#### 3 4. Frivolous Return Penalties

4 The United States contends that the Nichols are liable for penalties  
5 associated with submitting frivolous returns in the years 2005–2008. ECF No. 31  
6 at 17. The Nichols have not responded to this contention. *See* ECF No. 38.

7 The tax code imposes a civil penalty of \$5,000 upon any person who (1)  
8 “files what purports to be a return of a tax imposed by this title but which” (2)  
9 contains insufficient information on which the substantial correctness of a return  
10 can be assessed or information that is on its face “substantially incorrect,” and (3)  
11 the filing “is based on a position which the Secretary has identified as frivolous” or  
12 “reflects a desire to delay or impede the administration of Federal tax laws.” 26  
13 U.S.C. § 6702(a); *see also O’Brien v. C.I.R.*, 104 T.C.M. (CCH) 620 at \*4 (2012).  
14 The statute grants the Secretary authority to prescribe a list of positions identified  
15 as frivolous. § 6702(c).

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16  
17 <sup>5</sup> The Court does not conclude that the Nichols are liable for additions pursuant to  
18 26 U.S.C. § 6651(a)(2). The Nichols’ filed returns showed no tax liability and the  
19 Nichols could not therefore fail to pay the liability shown on their returns, *i.e.* zero.  
20 *Cf. Linmar Prop. Mgmt. Trust*, 96 T.C.M. (CCH) 176 at \*12.

1 The Court makes the following findings of undisputed fact:

- 2 (1) The Nichols filed documents annually from 2005–2008 purporting to  
3 be tax returns and asserting that the Nichols had received taxable  
4 income as defined by the United States tax code. ECF Nos. 33-32  
(2005); 33-34 (2006); 33-36 (2007); 33-38 (2008).
- 5 (2) In 2005, the Nichols reported no income. ECF No. 33-32.  
6 Documents filed with the IRS by third-parties indicate that Don  
7 Nichols received \$27,300.00 in nonemployee compensation from  
8 Bethlehem Construction, Inc., and that Terry Nichols received  
9 \$33,839.63 in wages from North Central Care Center. ECF No. 33-33  
10 at 7–8.
- 11 (3) In 2006, the Nichols reported no income. ECF No. 33-34.  
12 Documents filed with the IRS by third-parties indicate that Don  
13 Nichols received \$51,558.16 in wages from Executive Flight, Inc.,  
14 and that Terry Nichols received \$17,158.99 in wages and \$17,249.00  
15 in nonemployee compensation from North Central Care Center. ECF  
16 No. 33-35 7–9.
- 17 (4) In 2007, the Nichols reported no income. ECF No. 33-36. Documents  
18 filed with the IRS by third-parties indicate Don Nichols received  
19 \$88,052.61 in wages from Executive Flight, Inc., and that Terry  
20 Nichols received \$31,268.71 in nonemployee compensation from  
North Central Care Center. ECF No. 33-37 at 9–10.
- (5) In 2008, the Nichols reported no income. ECF No. 33-38.  
Documents filed with the IRS by third-parties indicate that Don  
Nichols received \$109,873.11 in wages from Executive Flight, Inc.,  
and that Terry Nichols received \$7,931.95 in nonemployee  
compensation from North Central Care Center. ECF No. 33-39 at 8–  
9.

18 These undisputed facts establish that the Nichols' returns from 2004–2008  
19 lacked information on which the substantial correctness of the return could be  
20 judged and, in fact, contained information that was substantially incorrect. *See*

1 *O'Brien*, 104 T.C.M. (CCH) 620 at \*5 (“RPS reported on the original Form W–2  
2 that it was petitioner's employer and that it had withheld certain taxes on her  
3 wages. On her Form 1040X petitioner claimed that she received no wages while  
4 admitting that income tax was withheld from the amounts paid to her by RPS. By  
5 reason of the above, petitioner's Form 1040X was substantially incorrect on its  
6 face. Furthermore, the Form 1040X did not contain information on which the  
7 substantial correctness of petitioner's reported tax liability could be evaluated.”).

8 Further, the IRS “has identified as frivolous a position that wages or other  
9 compensation received are not taxable income.” *Id.*; *see also* Notice 2008-14,  
10 2008-1 C.B. 310 (January 28, 2008); Notice 2007-30, 2007-1 C.B. 883 (April 2,  
11 2007); Rev. Rul. 2004-34 (March 22, 2004). “A return that reports taxable income  
12 and tax of zero is frivolous in circumstances where a third-party payor has reported  
13 on an information return that the taxpayer had income and that income tax was  
14 withheld on that income.” *O'Brien*, 104 T.C.M. (CCH) 620 at \*5. The Nichols  
15 attached to each return a document indicating they had not received wages as  
16 defined by the tax code, but third-party payor documents indicated that the Nichols  
17 did, in fact, receive wages or compensation each year. The Nichols’ position in  
18 each tax year was frivolous.

19 The Court concludes that (1) the Nichols filed what purported to be a tax  
20 return each year from 2004–2008, (2) the Nichols’ returns contained insufficient



1 information and information that was on its face substantially incorrect, and (3) the  
2 Nichols' position in filing these "zero returns" had been identified as frivolous by  
3 the IRS at the time of each filing. The United States is entitled to adjudication that  
4 the Nichols are liable for a \$5,000 penalty pursuant to 26 U.S.C. § 6702(a) for the  
5 years 2004–2008.

### 6 5. Interest

7 Finally, the United States requests the Court to rule that "the Nichols are  
8 liable for statutory interest upon all of their liabilities for assessed taxes and  
9 penalties." ECF No. 31 at 18. The Nichols have not responded to this contention.  
10 *See* ECF No. 38.

11 The tax code imposes interest upon any amount of tax not paid on or before  
12 the last date prescribed for payment. 26 U.S.C. § 6601(a). The tax code also  
13 imposes interest upon "any assessable penalty, additional amount, or addition to  
14 the tax" if that amount is not paid within twenty-one days of notice and demand  
15 thereof and running from the date of notice and demand. § 6601(e)(2)(A). Interest  
16 under § 6601(e)(2)(A) is mandatory. *Purcell v. United States*, 1 F.3d 932, 943 (9th  
17 Cir. 1993). The United States is entitled to adjudication that interest applies to the  
18 Nichols' tax liabilities, including penalties and additions. However, the United  
19 States must establish the dates of notice and demand, and the proper accounting of  
20 interest, before the Court can grant judgment on the matter. *See id.* (concluding

1 that the date of notice and demand is a factual matter that must be determined by  
2 the trier of fact).

3 C. Status of Last Day Trust

4 The United States contends that Last Day Trust was a nominee entity for the  
5 Nichols. ECF No. 31 at 20. The Nichols have conceded this point. ECF No. 38 at  
6 2. Accordingly, the United States is entitled to adjudication that Last Day Trust is  
7 a nominee entity for the Nichols.

8 **ACCORDINGLY, IT IS HEREBY ORDERED:**

- 9 1. The United States' Motion for Partial Summary Judgment (ECF No. 31) is  
10 **GRANTED in part** as discussed herein.

11 The District Court Executive is hereby directed to enter this Order, provide  
12 copies to counsel, and mail a copy to the address of record for Defendant Last Day  
13 Trust.

14 **DATED** May 28, 2015.



18  
19  
20

A handwritten signature in blue ink that reads "Thomas O. Rice".

THOMAS O. RICE  
United States District Judge